

General Information Letter: Individual with an IRC Section 1341 credit for claim-of-right income relinquished during the tax year is entitled to a subtraction for the amount relinquished, but may not carry over any resulting negative net income.

April 5, 2005

Dear:

This is in response to your letter dated March 3, 2005, in which you request advice. Department of Revenue ("Department") regulations require that the Department issue only two types of letter rulings, Private Letter Rulings ("PLRs") and General Information Letters ("GILs"). PLRs are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. GILs do not constitute statements of agency policy that apply, interpret or prescribe the tax laws and are not binding on the Department. For your general information, the regulation governing the issuance of letter rulings, 2 Ill. Adm. Code Part 1200 regarding rulings and other information issued by the Department, can be accessed at the Department's website. That address is [www.revenue.state.il.us/legalinformation/regs/part1200](http://www.revenue.state.il.us/legalinformation/regs/part1200).

The nature of your question and the information provided require that we respond only with a GIL.

In your letter you state in part as follows:

In 2003, I received \$4300.00 in unemployment compensation which was reported on both my 2003 Federal and Illinois Income Tax Returns. I was required to pay back \$3655.00 in 2004, which was repaid on July 14, 2004. I am enclosing documents to verify this transaction: (1) a copy of the bill I received requesting the repayment of the \$3,655.00 to the Illinois Department of Unemployment Security, (2) a copy of my cancelled check (number 10266) deposited by IDES, and my 2003 Federal 1040 Form filed, and (4) my worksheet showing the figures I used for TeleFiling my 2003 Illinois State Income Tax Return.

As you can see from my filed 2003 Federal and State Income Tax Returns, the \$3,655.00 amount was included as part of my 2003 income reported to both the IRS and Illinois Department of Revenue. Because I repaid the \$3,655.00 in 2004, the income on which I paid income taxes is overstated on both my Federal and State 2003 Income Tax Returns.

When I called the Illinois Department "Help Line" (phone number 217-782-3336) to find out how I should report on my IL-1040 tax return this repayment and recover the tax I overpaid to Illinois in 2003, (\$109.65), I was told it was not possible to get the refund unless I file an Amended Illinois 2003 Tax Form, and that I could only do that if I filed an Amended Federal Tax Form for 2003.

My only income in 2004 was \$13,059 of Social Security Disability. I do not owe any state or Federal 2004 taxes; however, I filed a Federal 2004 1040 Return (copy enclosed) to recover income tax I overpaid in 2003 on the unemployment compensation repaid in 2004. To recover the Federal taxes, I elected to take the Miscellaneous Credit on Line 69 (of Form 1040), per Publication 525, and identify the tax credit as "I.R.C.

1341.” This method gave me a greater refund than filing an Amended Federal 1040X Form for the 2003 tax year.

Since we couldn’t resolve the problem, the person on the Help Line suggested I write the legal department. Can you help me recover this overpaid tax to which I feel I am entitled? I shouldn’t be required to take a reduced refund from the Federal government in order to get a refund from the State of Illinois.

For individual income tax purposes, the Illinois tax calculation starts with federal Adjusted Gross Income (AGI). That is the amount reported at Line 1 of the IL-1040. As a consequence, federal calculations used to determine tax liability which are made after AGI has been computed, such as the “Miscellaneous Credit on Line 69 of Federal Form 1040, are not included in the Illinois tax calculation. Therefore, the DOR “Help Line” correctly stated the general rule: In order to file an amended IL-1040 due to a change of the federal tax calculation (i.e., in the US 1040), a US 1040-X is usually required. This is based on the presumption that the federal change necessitating the re-calculation of Illinois tax results from a change to federal AGI that consequently reduces Line 1 income reported on the IL-1040. Anything not reducing federal AGI is normally irrelevant for Illinois income tax purposes.

There is, however, an exception to this rule that directly applies to this type of case. Illinois Income Tax Act Section 203(a)(2)(P) provides a special Illinois deduction for: “[a]n amount equal to the deduction used to compute the federal income tax credit for restoration of substantial amounts held under a claim of right for the taxable year pursuant to Section 1341 of the Internal Revenue Code of 1986.”

As a result of this deduction, the IITA authorizes a person in your situation to recover the overpayment resulting from, e.g., repayment of the \$3,655.00 of 2003 unemployment benefits in 2004 even though, for federal purposes, the calculation of this item occurred after AGI. A person claiming this subtraction would not need to file a US 1040-X (and forfeit the Line 69 credit) in order to also receive an Illinois benefit. Rather, the appropriate course of action would be to claim the IITA 203(a)(2)(P) subtraction on form IL-1040 (or Form IL-1040-X, if an amended return was required) for the taxable year in which the unemployment compensation was repaid – 2004. This subtraction would be taken on Line 9 of the IL-1040 under “Other subtractions,” and would need to be supported by attaching Schedule M. In so doing, you should record the amount repaid (\$3,655.00) at Lines 12, 18, and 32 of Step 3 of that Schedule.

It appears that despite the existence of the IITA 203(a)(2)(P) deduction, for practical purposes you will still obtain no relief. The problem is that your only income for 2004 was \$13,059 of Social Security Disability. Under IITA 203(a)(2)(L), all Social Security benefits included in federal AGI are deductible. Social Security benefits that are not included in federal AGI are not required to be added back when computing Illinois taxable income. Your federal AGI for 2004 was (\$-182.31), which is the figure that would carry over to Line 1 of your IL-1040. Thus, unless you have any Illinois addition modifications for 2004, the year in which you could claim the IITA 203(a)(2)(P) deduction, you will have no income to deduct it against. We regret that the circumstances prevent a more desirable result.

As stated above, this is a GIL which does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you wish to obtain a PLR which will bind the Department with respect to the application of the law to specific facts, please submit a request conforming to the requirements of 2 Ill. Adm. Code Part 1200.

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Sincerely yours,

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